



February 9, 1998

Mr. William Pascoe
Chair, [IndeGO Steering Committee](#)
c/o Kristi Wallis, IndeGO Coordinator
716 39th Avenue NW
Seattle, WA 98122

Dear Mr. Pascoe:

The Energy Policy Group of the Washington Department of Community, Trade and Economic Development (CTED) is pleased to offer these comments on the IndeGO proposal for an independent transmission system operator in the Northwest and Rocky Mountain regions. CTED applauds the signatories of the IndeGO Memorandum of Understanding (MOU) for conducting an open process and for soliciting the participation of state agencies and other non-signatories, and congratulates all participants in the grueling process of crafting this proposal for a job well done. CTED endorses both the concept of an independent grid operator as a neutral gatekeeper to the transmission grid and the IndeGO proposal as a good start towards a fair, workable embodiment of that concept.

CTED's participation in the IndeGO discussions is rooted in its mission to facilitate the inclusion of public interest criteria into state, regional, and national energy policy. CTED views the public interest in transmission system operation as lying in the following areas:

- Facilitating public involvement in major decisions regarding the planning and operation of the region's transmission system;
- Ensuring that the regional transmission system is operated reliably and for the benefit of all customers, not just its owners;
- Facilitating efficient wholesale power markets and sending good price signals for efficient operation and expansion of the transmission grid;
- Ensuring that non-transmission alternatives, such as demand-side management and distributed generation, are considered in the planning and grid expansion processes;
- Ensuring the equitable treatment of intermittent renewable generation;
- Establishing an equitable method of recovering transmission system costs; and

- Preserving and enacting the region's mandate for change in the electric power industry as reflected in the Final Report of the Steering Committee of the Comprehensive Review of the Northwest Energy System.

CTED recognizes that the IndeGO proposal is still in its formative stages, and that the jury is still out on whether the benefits of forming IndeGO will ultimately outweigh the costs. CTED does not endorse every aspect of the proposal, and offers suggestions below in areas where it can be improved. These include strengthening the commitment to operate openly and in full public view, establishing two membership classes for retail customers, explicitly encouraging planners to examine non-transmission alternatives on an equal basis with transmission projects, and re-examining the congestion management model with an eye toward reducing complexity and mitigating the potential for locational market power. CTED also urges the MOU signatories to work to find ways to reduce the cost of forming and operating IndeGO, and to improve the techniques for estimating the less easily quantifiable benefits of independent transmission system operation such as reduced ability to exercise market power. Notwithstanding these recommendations, CTED finds the IndeGO proposal to be broadly acceptable and urges the MOU signatories to continue the process of forming IndeGO.

In keeping with the principles above, CTED offers the following comments and suggestions for improving the final proposal.

Facilitating Public Involvement

CTED believes that openness and informed public involvement are critical to the success of any entity that is charged with upholding the public trust. IndeGO, as a nonprofit corporation designed to act in the public interest, is likely to be accorded a significant degree of deference by its regulator, the Federal Energy Regulatory Commission (FERC). Consequently, meetings of the IndeGO Board of Trustees (Board), Technical Advisory Committee (TAC), Planning Issues Committee (PIC) and Area Planning Issues Committees (APICs) are likely to be the primary forums in which decisions are made regarding operation of the transmission system, transmission system investments, and other issues which affect the public interest. Every effort should be made to ensure that the public is not only allowed but encouraged to attend and participate in these meetings. CTED has two suggestions for improving the proposed governance structure to facilitate public involvement: a more explicit commitment to openness, and the formation of two membership classes for retail customers.

The by-laws call for all meetings of the Board to be open to the public unless a majority of the Board votes to convene a closed session. The Board may wish to do so for a number of reasons; the by-laws list the following confidential matters the Board may wish to discuss in a closed session: litigation or potential litigation; personnel matters; vendor or contractor selection; real estate transactions; and proprietary information. These are legitimate reasons to exclude the public from a portion of a Board meeting; however, CTED is concerned that there is no restriction on matters that can be discussed once a closed session has been convened. Recognizing that it is impossible to imagine all confidential matters the Board may wish to discuss, CTED proposes changes to the language of Article V, Section 9 of the by-laws to the following effect: the Board may convene in a closed session upon a majority vote of Trustees

present to discuss any one or more of a list of confidential matters, such as the one above, enshrined in the by-laws; however, no matters other than those on the list may be discussed at a closed session except upon unanimous agreement of all Trustees present. CTED also suggests the inclusion of language clarifying that non-voting (ex-officio) Trustees may attend any closed session. CTED believes that these minor changes to the by-laws would significantly reduce the potential that important, non-confidential decisions could be made behind closed doors.

CTED also urges the signatories not to wait for the Northwest Regional Transmission Association (NRTA) and/or the Western Regional Transmission Association (WRTA) to address the issue of official membership for retail customers. ISOs differ in meaningful ways from the existing regional transmission associations (RTAs). Most importantly, the RTAs do not file tariffs with FERC for the purpose of recovering costs from captive customers. CTED and others are concerned that the formation of IndeGO will move the forum for protecting the interests of retail customers from local boards and state public utility commissions to a distant FERC which may be inclined to grant deference to the decisions of nonprofit ISOs. For this reason, CTED suggests that IndeGO proposal address the establishment of two classes of membership for retail customers. The first class would consist of the consumer counsel or other state-authorized representative of retail customers from each state, with one vote per state. In Washington, for example, the representative would be the Public Counsel Section of the Attorney General's office; in Oregon, the Citizens Utility Board. The second class would consist of large retail customers that wish to represent themselves (or designate a representative other than their states' consumer counsel). Voting in the large retail customer class would be by megawatts of load. These classes would have the same rights as the current RTA classes of major transmitting utilities, transmission-dependent utilities, and non-utility generators to nominate and vote for Trustees and designate members of the TAC. Formation of these two classes would do much to safeguard the interests of captive retail customers, especially those without the resources to represent themselves in FERC rate cases.

Independent Governance

CTED endorses the participants' choice of an independent Board of Trustees elected by member classes over a representative and/or self-perpetuating Board. CTED believes that a representative Board would prove too unwieldy and too prone to intrigue and self-interested behavior to exercise proper oversight of IndeGO staff, while a self-perpetuating Board may not be sufficiently responsive to the needs of customers. An independent Board elected by member classes strikes the right note of independent oversight while ensuring that Trustees are acceptable to a broad spectrum of IndeGO customers.

Reliable Operation

CTED does not believe that IndeGO operations, as envisioned in the proposal, would be a threat to the reliability of the region's bulk transmission system. On the contrary, ceding operational control to a market neutral entity would likely enhance system security and reliability.

IndeGO will act as the region's security coordinator and will operate a NERC-certified control area. Through the transmission control agreements and generation and load integration

agreements, IndeGO operators will have at their disposal all the tools that existing control area operators have. IndeGO will have one advantage over the current arrangement, however: a neutral position in the marketplace. Currently, utilities have a financial incentive to push the system up to and perhaps beyond its limits; more throughput means more revenue, in the form of wheeling payments, increased power sales, or both. The consequences of pushing the system beyond its limits, namely, system outages, fall most heavily on other parties: end-users, competitors, and customers of competitors, often in faraway states. It is a credit to the industry that utilities have, almost without exception, adhered to voluntary rules to preserve system security in the face of these perverse financial incentives. The industry is changing, however, and the current system is already showing strains with the advent of wholesale competition. Retail competition will greatly magnify the problem. Turning over control of the grid to a market neutral entity would remove incentives that may already be undermining system reliability.

Of course, care must be taken not to give incentives for overly conservative behavior on the part of IndeGO operators. The region would suffer economic losses if transmission capacity were artificially constrained due to overly stringent reliability criteria. CTED looks forward to working with the IndeGO parties to design an incentive system that balances system security with economic gains from wholesale power exchange.

Efficient Wholesale Power Markets

Facilitating efficient wholesale power markets is the *raison-d'être* of ISOs. There are a number of areas where the IndeGO proposal offers superior qualities to the existing system, and to alternative proposals that have been considered by the MOU signatories:

- By collecting the fixed costs of the system via a load-based access fee, IndeGO would remove "pancaked" transmission rates, eliminating artificial barriers to economic trades.
- By tariffing and controlling access to all FERC-jurisdictional transmission, not just the high-voltage system, IndeGO would eliminate the potential for "vertical pancaking" and ensure that only one party stands between the generator and the wholesale customer.
- By acting as a neutral gatekeeper to the transmission grid, IndeGO would eliminate a company's ability to use its transmission system ownership to the strategic advantage of its generation business, i.e., its vertical market power.
- By establishing transmission capacity reservations (TCRs) as tradable rights, IndeGO would ensure economic rationing of scarce transmission capacity.
- By accepting all schedules and defining TCRs as financial instead of physical rights, IndeGO would avert the possibility that a deep-pocketed company could hoard transmission capacity to the detriment of its competitors.
- By both billing and paying the marginal cost of congestion clearing, IndeGO would minimize the ability of parties to seek congestion rents through strategic bidding, the withholding of beneficial schedules, or other "gaming" of the congestion management system.

Although certain elements of the proposal need to be refined, CTED is satisfied that the proposal as it exists does as much as is possible short of full divestiture to mitigate vertical market power.

CTED is concerned, however, about the commercial complexities and potential for locational market power implied by some aspects of IndeGO's congestion management proposal. In particular, CTED urges the signatories to revisit the choice of a 1% threshold for congestion cost responsibility, the preliminary decision to define 28 congestion management zones, and the intent to update the matrix of distribution factors on a daily basis. The combination of these factors means that companies would have to monitor congestion on literally dozens of paths for each proposed generation-to-load schedule. Companies would have only limited ability to hedge congestion costs, since they wouldn't know where they need TCRs until the final distribution matrix is posted prior to the day-ahead market. This defeats the purpose of establishing tradable transmission rights, which is to allow parties to consummate low-margin deals by locking in costs in advance. The large number of congestion zones also greatly increases the likelihood that some generators will be able to exercise market power within a given congestion zone. CTED looks forward to working with the IndeGO parties as they seek to balance the need for a simple commercial model with the desire to send accurate price signals for efficient operation and expansion of the grid.

Consideration of Non-Transmission Alternatives

Planning in an environment where utilities are no longer vertically integrated presents some new challenges. One of those challenges is to ensure that non-transmission solutions are considered on an equal basis with potential transmission projects. The traditional, vertically integrated utility can plan its entire system according to least-cost principles; it has no particular incentive to favor one type of project over another. When generation and transmission are unbundled, care must be taken to ensure that planning processes continue to point to the least cost solution, particularly in light of the very different risk profiles that merchant generation and rate-based transmission may present.

The proposal to have new inter-zonal bulk transfer facilities financed by the market in response to congestion price signals goes a long way towards ensuring that generation, load management and transmission projects will compete on equal terms as ways for companies to reduce their exposure to congestion costs. Transmission capacity between two congestion management zones will have an explicit and visible value, equal to the difference in the value of energy between the two zones at any given time. It will be relatively simple for companies to calculate what investments, if any, are warranted by that difference.

This is not the case for local, reliability-driven investments, however. Especially given the rapidly changing technological picture, there may be instances where a strategically placed small generator is a more economical solution to a local reliability problem than new transmission investment. CTED does not recommend that IndeGO own or plan generation, but does believe that APICs should be explicitly encouraged to consider whether a generation or other non-transmission project may be a more economical solution to a given problem than new transmission facilities. To that end, CTED proposes that language be added to Section 3.3 of the Entity Charter ("IndeGO's Planning Responsibilities"), and anywhere else that IndeGO's planning functions are described, requiring APICs to consider non-transmission alternatives as solutions to local reliability problems. If the alternative is found to be the most cost-effective, the APIC would facilitate the formation of a consortium of IndeGO customers to construct the

project. Load management and/or conservation projects that are identified as the most cost-effective fix to a transmission problem could be financed by the local area and rolled into the area rates. If the project is generation, it would be financed by the consortium and treated like any other generation facility.

Equitable Treatment of Intermittent Renewables

By choosing a load-based access fee, IndeGO avoids the question of the appropriate billing determinant for intermittent renewable generation resources such as solar and wind. The IndeGO proposal is beneficial to potential developers of intermittent resources because project owners would pay no transmission costs other than congestion and losses. Since intermittent renewable resources cannot be turned on or off, owners are likely to act as "price takers", simply paying whatever charges accrue for congestion and losses rather than engaging in expensive hedging strategies. The proposed congestion management scheme may confer additional advantages on distributed intermittent renewable generation. These resources cannot be bid as explicit congestion relief strategies, but distributed renewables such as solar photovoltaic may prove to be a cost-effective strategy for customers on the downstream side of a congested interface to reduce their exposure to congestion charges, particularly in summer-peaking regions where peak transmission system use coincides with intense summer sunlight.

Equitable Fixed-Cost Recovery

CTED endorses the signatories' choice of a load-based access fee determined through the allocated area rate methodology. A load-based access fee removes sunk transmission system costs from the list of factors considered in siting generation, and the movement towards uniform prices across access pricing areas will help to ensure that providers of a regulated monopoly service are not forced to compete with each other to the detriment of important public policy goals such as equitable fixed cost recovery. By allocating sunk transmission system costs on the basis of existing inter-utility relationships, the allocated area rate methodology represents an equitable division of sunk costs among regions. The blending of costs within an access pricing area, rather than across the entire IndeGO system, minimizes cost shifts compared to an IndeGO-wide "postage stamp" access fee. And the proposal to have access pricing areas plan and finance local, low-voltage additions to the system provides a good balance between ensuring that load can be served and "gold-plating" of the transmission system. Finally, CTED finds that the choice of a 12 coincident peak billing determinant is a good compromise between the interests of low-load factor and high-load factor customers, and notes that nothing in the proposal restricts the ability of local boards and state commissions to adopt different methods of allocating transmission costs to retail customers under their jurisdiction.

Consistency with Comprehensive Review

The Comprehensive Review of the Northwest Energy System, convened in 1996 by the governors of Washington, Oregon, Idaho and Montana, provided a blueprint for the future of the region's electric power industry. Participants in this review included representatives of nearly all stakeholders in the region, and the final report represents a consensus view of the region's energy future among a wide range of constituencies. CTED believes that it is important to preserve this

consensus as the region moves forward with steps to restructure the industry. The Comprehensive Review called for "the formation of an IGO, regulated by FERC and including the transmission assets of Bonneville and the other owners of major transmission assets in the region." The review called for the IGO to have:

- Operational control over the transmission system and enough operational control of generation to ensure short-term reliability;
- Responsibilities in other areas, such as maintenance, planning and expansion;
- Clear incentives to maintain reliability and encourage the efficient use of the system;
- A grid-wide tariff which would eliminate pancaking of transmission rates;
- Fair treatment of "intermittent, as-available and distributed generation"; and
- Transmission system planning that follows long-term least-cost planning principles.

CTED finds that the IndeGO proposal is consistent with the recommendations of the Comprehensive Review in all of its major principles.

Conclusion

In summary, CTED endorses the IndeGO proposal for an independent transmission system operator in the Northwest and Rocky Mountain regions. With the inclusion of the recommendations outlined above, the proposal would meet all of CTED's public policy goals for a regional ISO: mitigating vertical market power; facilitating efficient wholesale power markets and efficient expansion of the grid; ensuring equitable treatment of intermittent renewable resources; recovering sunk transmission system costs in an equitable manner; and providing ample opportunity for public involvement in major transmission system decisions. In addition, CTED finds that the proposal meets the specifications for an independent grid operator laid out in the Comprehensive Review of the Northwest Energy System and encourages Bonneville and the Transition Board to continue to work towards removing legal impediments to Bonneville's full participation.

CTED shares the concern of many that the quantifiable benefits of forming IndeGO have thus far not been shown to outweigh the costs. Methods to reduce the costs of formation, such as building on existing transmission control facilities, should be explored to the maximum possible extent. A simple summation of costs and benefits can be deceiving, however; while the costs of constructing a new facility, hiring a certain number of transmission system planners, etc. are easily estimated, many of the benefits of an IGO, such as mitigating market power, providing improved access, and more efficient expansion of the grid, are much more difficult to quantify. CTED urges the MOU signatories not only to work to find ways to reduce the cost of forming and operating IndeGO, but also to improve the techniques for estimating the less easily quantifiable benefits of independent transmission system operation.

Finally, CTED reminds the MOU signatories and the region that the IndeGO proposal should not be evaluated based on a comparison to today's system, but on what the system may look like in five, ten and fifteen years. The ability of today's system to reliably handle the geometrically increasing volume of transactions and the increasingly cutthroat nature of the wholesale power market is very much in question, and today's system of open access governed by FERC Order

888 and the WRTA Available Transmission Capacity (ATC) document is merely one stage in the continuing evolution of the nation's transmission system. CTED encourages all parties in the region to continue to work towards a long-term solution to the problem of open transmission access that advances the policy goals outlined above.

Thank you again for this opportunity to comment on the IndeGO proposal.

Sincerely,

K.C. Golden
Assistant Director